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Investors May 'Prefer' to Look Elsewhere for Yield

With yield so scarce today, investors are branching out into different asset classes in their search for income. Many investors have set upon preferred stock, a hybrid security usually issued by highly leveraged companies, such as financial institutions, telecoms, and utilities. Preferred stock has characteristics of both bonds and stocks. Like stocks, preferreds are traded daily on an exchange. Like bonds, they pay fixed income on a regular basis (usually quarterly), but typically they do not offer as much capital appreciation potential as common stock. In the capital structure, preferred stock is senior to common stock but junior to corporate bonds, and preferred shareholders have no voting rights.

Preferred stock is not without its headwinds. In fact, there are many significant risk factors that investors must consider. Heavy exposure to financials, regulation changes, and rising interest rates are foremost on this list. Preferreds are sensitive to interest rates, but unlike bonds, they are at risk in both directions. When rates fall (presently an unlikely event), issuers often call shares to reissue at lower, more favorable rates. When rates go up, preferred stock share prices fall. Preferreds also have call options backed in, usually about five years after issuance, but some can be called even before then. Issuers can suspend dividend payments during rough periods, and in the event of bankruptcy, owners will walk away with nothing (for example, investors in preferred shares from Fannie and Freddie lost everything). In conclusion, preferred stocks' high yields may be alluring to income-seekers, but investors should approach this space with caution.

Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than other asset classes.

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Advisor Corner

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2014 Market Performance
01-01-2014 to 4-30-14
DJIA ^DJI Up .03%
S&P 500 ^GSPC Up 1.93%
NASDAQ ^IXIC Down (1.49%)
Russell 2000 ^RUT Down (3.16%)

* Index performance does NOT include any fees (Gross of fees)

Source: http//finance.yahoo.com

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Five Reasons to Let a Sleeping 401(k) Lie

Letting money sit tight in an old 401(k) plan is the path of least resistance, which is why many participants let their assets sit in the plans of former employers. This, of course, may be better than cashing the money out and spending it. Investors younger than 55 pay ordinary income taxes and a penalty on any premature distributions, which can diminish a 401(k) balance considerably. But there are also other reasons why staying put in a former employer's plan may be the best course of action.

1) Investors can't buy comparable investments on their own. One of the key reasons to stay put in a former employer's plan is if it offers investment options that are unavailable to smaller, individual investors. Institutional share classes of funds, which typically feature very low costs, are one such example. Another reason to leave money behind in an old 401(k) plan is to take advantage of a stable-value fund. This may be important for investors who are nearing retirement and looking to keep their portfolios steady, but not for younger employees who may not have such a great need for stability.

2) Investors may need early access to their money. Investors in 401(k) plans who have left their employers have another lever that IRA investors do not: the ability to tap their assets a touch earlier—at age 55 (Source: IRS 401(k) Resource Guide - Plan Sponsors, General Distribution Rules). To be eligible, workers must reach age 55 (or older) sometime during the year they retire. By contrast, IRA investors and 401(k) investors who retire before age 55 must wait until age 59 1/2 if they want to avoid the 10% early withdrawal penalty. Thus, for an investor closing in on that age who would like to have access to cash, staying put in the previous employer's 401(k) will make more sense than rolling the money over. However, it is a good idea to fully assess the portfolio's long-run sustainability before contemplating withdrawals at such an early age. Also note that some 401(k) plans may not allow the age 55 withdrawal option.

3) Investors could need the extra legal protections. Legal protections are another reason to consider staying put in an old 401(k). Although laws regarding creditor protections for retirement assets vary by state, company retirement plan assets generally have better protections from creditors and lawsuits than do IRA assets. Obviously, these protections will be a bigger consideration for those who have had credit or bankruptcy problems or who work in a profession where they may be sued.

4) Investors own company stock in their 401(k)s. When employees hold company stock in their 401(k) plans, staying put may offer a tax advantage versus rolling the money over. When company stock is held in a company retirement plan, stockholders pay capital gains tax on any appreciation over and above their cost basis when they sell the shares to take distributions in retirement (This differential is called net unrealized appreciation, or NUA). When rolling over the company stock into an IRA, on the other hand, stockholders pay ordinary income tax on the distributions they take when in retirement.

5) Investors may need the structure. Keeping the money in a 401(k) plan can provide at least a few safeguards. After all, these plans are overseen by fiduciaries who are legally required to look out for participants' interests, so the funds in the lineup tend to be well-diversified. However, investors should be aware that there may be differences in fees and expenses between 401(k) and IRA plans, and should investigate these fees and expenses carefully before making a decision.

401(k) and IRA plans are long-term retirement-savings vehicles. Withdrawal of pretax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Please consult with a legal, financial, or tax professional for advice specific to your situation.

Find the Right IRA in Three Easy Steps

Even if you're already convinced that saving in an IRA is a sensible thing to do, there's still a little bit of research to conduct. There are two main types of IRA accounts, and selecting the one that's best for you can be a daunting process. You can figure this out in relatively short order by following these three steps.

1) Know the Basics: Understanding the difference between the two types of IRAs—Roth IRAs and traditional IRAs—is the key first step in determining which is suitable for you.

Both vehicles let you sock away money and enjoy a tax benefit. With a traditional IRA, you won't have to pay taxes on your IRA's investment earnings until you begin taking distributions from it during retirement; thus, your money enjoys the benefit of tax-deferred compounding. (That means you'll have to pay taxes on your earnings when you begin withdrawing money, but not as you go along.) The Roth, however, has a couple of huge advantages over a traditional IRA. Whereas traditional IRAs carry restrictions governing when you have to begin taking distributions, the Roth carries no such restrictions; you won't be forced to take distributions at any age. And perhaps even more significantly, qualified distributions from a Roth will be tax-free, not tax-deferred as is the case with a traditional IRA.

With that information, the choice might seem clear: Roth IRA all the way. But there are a few other issues to consider. For those who qualify (consult a tax professional or the IRS' site to determine if that's you), a traditional IRA provides up-front tax savings. All of your contribution to a traditional IRA plan could be tax-deductible. Contributions are not tax-deductible with a Roth IRA.

2) Determine Your Eligibility: Okay, you've now identified the account type that suits you, but there are eligibility hurdles you'll have to clear in order to use a traditional IRA or a Roth IRA.

Let's start with the most sweeping limits first. For 2014, according to IRS Publication 590, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified adjusted gross income (AGI) is: more than $96,000 but less than $116,000 for a married couple filing a joint return or a qualifying widow(er); more than $60,000 but less than $70,000 for a single individual or head of household; or less than $10,000 for a married individual filing a separate return.

For 2014, according to Publication 590, you cannot make a Roth IRA contribution if your modified AGI is $191,000 or more if your filing status is married filing jointly; $129,000 or more filing single, head of household, or married filing separately, and you did not live with your spouse at any time in 2014; or $10,000 or more if your filing status is married filing separately and you lived with your spouse at any time during the year.

3) Weigh Your Options: You may find that certain IRA types are automatically off limits to you because of your income level. But what if you establish that you're eligible to make more than one type of IRA contribution—for example, you can contribute to a Roth and make a deductible contribution to a traditional IRA? You may decide to do both if you have the money to do so, but if you have a limited sum of money to invest, the decision becomes a bit tougher. For a situation like this, as well as to keep abreast of the latest rules and regulations pertaining to IRAs, it would be in your best interest to consult with your financial advisor/tax professional.

Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free, and can be withdrawn tax free if assets are held for five years. A 10% federal tax penalty may apply for withdrawals prior to age 59 1/2.

Tune Out the Noise

There's a reason that investors tend to only hear about "looming" market doom or "imminent" market growth. While many news outlets have incentive to draw viewer attention with wildly bullish or bearish predictions, these sensationalized views may be a distraction to a sound investment approach. When tempted to make a radical change to your investment portfolio based on these headlines, it is important to recall some basic fundamentals to keep your plan on track.

Drown out the noise. Market movements are notoriously difficult to predict. The media outlets that scream the loudest are not always the most accurate. The fallout from attempting to time the market in response to one of these predictions can be dangerous to your portfolio.

Look, but don't stare. While it's important for investors to know the performance of their accounts, short-term market fluctuations can be quite volatile. While the probability of realizing a loss within any given day is high, the likelihood of realizing a loss historically has decreased over longer holding periods. Periodic review of an investment portfolio is necessary, but investors shouldn't let short-term swings affect their view of the future.

Stay focused on the long term. Investors who have taken the time to determine a sound investment plan based on specific goals and risk tolerances are best advised to stick to that plan. While it may not always grab headlines, a sensible, tailored investment plan may be the best solution to meeting long-term goals.

Holding a portfolio of securities for the long term does not ensure a profitable outcome, and investing in securities always involves risk of loss.

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